Sharing risk in Medicare Part D

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Roadmap

- Recap from October 2014 meeting
- Observed patterns of reinsurance and risk corridor payments
- Feedback from plan actuaries
- Numeric examples
- Next steps
Part D’s approach

- Private plans deliver drug benefits
  - Compete for enrollees
  - Drug-only plans or part of Medicare Advantage
- Medicare pays for nearly 75% of basic benefits, enrollees pay almost 25%
  - Monthly capitated payments to plans
  - Plan premiums vary depending on their bids
  - Medicare has other subsidies that offset risk
- Low-income subsidy provides extra help with premiums and cost sharing to 30% of enrollees
### Mechanisms for and objectives of risk sharing in Part D

<table>
<thead>
<tr>
<th>Mechanism</th>
<th>Objective</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Direct subsidy</strong></td>
<td>Medicare’s subsidy that lowers premiums for all enrollees. Medicare pays plans a monthly capitated amount. Plan sponsors manage enrollees’ benefit spending because the sponsor loses money when spending is higher than payment + enrollee premium.</td>
</tr>
<tr>
<td><strong>Risk adjustment</strong></td>
<td>Counters the incentive for sponsors to avoid high-cost enrollees</td>
</tr>
<tr>
<td><strong>Individual reinsurance</strong></td>
<td>Counters the incentive for sponsors to avoid high-cost enrollees</td>
</tr>
<tr>
<td><strong>Risk corridors</strong></td>
<td>• Initially used to establish the market for stand-alone drug plans&lt;br&gt;• Protection against unanticipated benefit spending (e.g., introduction and wide use of a high-cost drug)</td>
</tr>
</tbody>
</table>
Individual reinsurance: Medicare pays for 80% of benefits above the OOP threshold

Initial coverage limit

<table>
<thead>
<tr>
<th>Enrollee 25%</th>
<th>Plan 75%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medicare 80%</td>
<td>Partial coverage, discounted price for brand-name drugs</td>
</tr>
</tbody>
</table>

Out-of-pocket threshold

<table>
<thead>
<tr>
<th>Enrollee 5%</th>
<th>Plan 15%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enrollee 100%</td>
<td>Plan 75%</td>
</tr>
</tbody>
</table>

Note: OOP (out of pocket).
Current structure of risk corridors: actual costs relative to bids

<table>
<thead>
<tr>
<th>90% of bid</th>
<th>95% of bid</th>
<th>105% of bid</th>
<th>110% of bid</th>
</tr>
</thead>
<tbody>
<tr>
<td>20% plan, 80% Medicare</td>
<td>50/50 Plan at full risk</td>
<td>50/50</td>
<td>20% plan, 80% Medicare</td>
</tr>
</tbody>
</table>

Plan gains 100% of bid Plan losses
Rapid growth in reinsurance payments, high cost of Low-Income Subsidy

Source: MedPAC based on Table IV.B.10 of the Medicare Board of Trustees’ report for 2014.
Timing of bids and reconciliation

- Benefit year starts January 1
- Previous June, sponsors submit bids with estimates of:
  - Benefit spending for an enrollee of average health (net of rebates and discounts)
  - Low-income cost sharing
  - Expected individual reinsurance
- CMS uses bids to set prospective payments
- 6 months after end of benefit year, CMS reconciles prospective with actual payments
Patterns of reconciliation payments

- Individual reinsurance
  - Sponsors underbid on catastrophic spending
  - Medicare paid plans
- Risk corridors
  - Sponsors overbid on rest of covered benefits
  - Actual benefits often 90% of bids or lower
  - Plans paid Medicare

Reconciliation payments from Medicare to plans in $billions

Source: MedPAC based on data from CMS.
Data are preliminary and subject to change.
Feedback from plan actuaries

- Some sponsors use smooth assumptions to project benefit spending
  - But growth rates differ by therapeutic class
  - Average trend understates catastrophic spending and individual reinsurance
- When bids are prepared, uncertainty about:
  - Market entrance and prices of drugs
  - Rebate and discount agreements
  - Numbers of LIS enrollees
An advantageous way to bid?

- Uncertainty in key factors that affect plan bids
- But we see a pattern in program’s reconciliation payments instead of randomness
- Reasonable to ask if there is a financial advantage in plans’ bidding approach
Potential plan approaches to bidding

- **Approach #1: focus on premiums**
  - Underestimate catastrophic spending
  - Overestimate rest of benefit spending (but not high enough to trigger a risk corridor payment)
    - Competitive premium
    - Recoup most of the cost “over-runs” above catastrophic threshold at reconciliation
    - Retain some “excess” profits above those already in bid
  - Lower cash flow due to lower prospective reinsurance payments
Potential plan approaches to bidding – cont.

- **Approach #2: aim for higher profits**
  - Underestimate catastrophic spending
  - Overestimate rest of benefit spending, high enough to trigger a risk corridor payment
    - ✓ Recoup most of the cost “over-runs” above catastrophic threshold at reconciliation
    - ✓ Retain larger “excess” profits, even after paying a portion back to Medicare
    - ✗ Less competitive (higher) premium
    - ✗ Lower cash flow due to lower prospective reinsurance payments
## Numeric example

<table>
<thead>
<tr>
<th></th>
<th>Plan bid</th>
<th>Actual cost</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plan at risk</td>
<td>$60.00</td>
<td>$54.00</td>
<td></td>
</tr>
<tr>
<td>Reinsurance</td>
<td>$40.00</td>
<td>$48.00</td>
<td>Higher covered benefit because coverage is more generous above catastrophic threshold</td>
</tr>
<tr>
<td>Total covered benefit</td>
<td>$100.00</td>
<td>$102.00</td>
<td></td>
</tr>
<tr>
<td>Enrollee premium (25.5%)</td>
<td>$25.50</td>
<td>$25.50</td>
<td>Should have been $26</td>
</tr>
<tr>
<td>Reconciliation</td>
<td></td>
<td>+$8</td>
<td>Additional payments from Medicare for higher reinsurance costs</td>
</tr>
<tr>
<td>Plan extra profit</td>
<td></td>
<td>+$6</td>
<td>Difference between $60 (direct subsidy/premium) and $54 (actual cost)</td>
</tr>
</tbody>
</table>
Potential policy approaches

- Combine changes to risk sharing with other policies to balance competing goals

- Risk sharing options
  - Risk for costs above catastrophic threshold (reinsurance)
    - Plans bear more risk (> 15%)
    - Private provision of reinsurance
  - Changes to risk corridors

- LIS policies
Next steps

- For the April meeting:
  - Conversations with private reinsurers
  - Additional analysis of reinsurance and risk corridors
- For the next cycle (Fall 2015 – Spring 2016):
  - Discussion of risk-sharing policy options
  - Revisit 2012 recommendation on LIS cost sharing?